(5) (4)

Nos. 95-966, 95-977

In The

Supreme Court of the United States

October Term, 1995

KEVIN M. O'GILVIE and STEPHANIE L. O'GILVIE, minors,

Petitioners,

-and-

KELLY M. O'GILVIE,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR PETITIONERS KEVIN M. O'GILVIE AND STEPHANIE L. O'GILVIE, MINORS

ROBERT M. HUGHES
Counsel of Record
JACK D. FLESHER
GREGORY L. FRANKEN
DAVID B. SUTTON
BEVER, DYE, MUSTARD & BELIN, L.C.
Attorneys for Petitioners Kevin M. O'Gilvie and Stephanie L. O'Gilvie, minors
106 West Douglas, Suite 700
Wichita, Kansas 67202
(316) 263-8294

STEPHEN R. McALLISTER
Of Counsel
University of Kansas School of Law
Green Hall
Lawrence, Kansas 66045
(913) 864-4550

8702-A
Lutz Appellate Services, inc.
(800) 3 APPEAL • (800) 5 APPEAL • (800) BRIEF 21

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QUESTIONS PRESENTED FOR REVIEW

I. Whether a punitive damages award received by minor children for the wrongful death of their mother in a personal injury lawsuit is excludable from gross income as "any damages received . . . on account of personal injuries . . ." under 26 U.S.C. § 104(a)(2)?

II. Whether the event which commences the two year statute of limitations under 26 U.S.C. § 6532(b), for a suit by the United States to recover a refund erroneously made, should be the issuance or mailing of the refund check by the government or its receipt by the taxpayer?

LIST OF AI L PARTIES TO THE PROCEEDINGS

Kevin M. O'Gilvie and Stephanie L. O'Gilvie, minors by and through INTRUST Bank, NA (formerly The First National Bank in Wichita), Conservator.

RULE 29.6 LISTING

Petitioners' Conservator, INTRUST Bank, NA is a wholly owned subsidiary of INTRUST Financial Corp., formerly First Bancorp of Kansas, Inc.

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OPINIONS BELOW

Kelly M. O'Gilvie v. United States, 66 F.3d 1550 (10th Cir. 1995), is reproduced in Pet. App. 1a-22a;[1] *Kelly M. O'Gilvie v. United States*, No. 90-1075-B Civ. (D. Kan. Aug. 26, 1992), 92-2 USTC ¶ 50,567, (Pet. App. 25a-27a) is unofficially reported at 92-2 USTC ¶ 50,567; and *Kelly M. O'Gilvie v. United States*, No. 90-1075-B Civ. (D. Kan. May 26, 1992), (Pet. App. 28a-36a) is unofficially reported at 92-2 USTC ¶ 50,344.

STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Tenth Circuit was entered on September 19, 1995. The petition for a writ of certiorari was filed on December 18, 1995, and was granted on March 25, 1996. The jurisdiction of this Court rests upon 28 U.S.C. § 1254(1).

The United States filed a complaint in the United States District Court for the District of Kansas, seeking to recover federal income tax refunds that had been paid to INTRUST Bank, NA, as Conservator of Kevin M. O'Gilvie and Stephanie L. O'Gilvie. The district court had jurisdiction under 28 U.S.C. § 1345.

STATUTORY AND REGULATORY PROVISIONS INVOLVED

1. Section 61(a) of the Internal Revenue Code of 1986, 26 U.S.C. § 61(a),[2] provides in relevant part:

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1. References to Pet. App. in this Brief are to the Appendix in the Petition for a Writ of Certiorari, Case No. 95-966.

2. Unless otherwise stated, all Section references are to the Internal Revenue Code, Title 26, United States Code, as in effect for the taxable year at issue.

GENERAL DEFINITION — Except as otherwise provided in this subtitle, gross income means all income from whatever source derived . . .

2. Section 104(a) of the Internal Revenue Code of 1986, 26 U.S.C. § 104(a), provides in relevant part:

IN GENERAL — Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include —

* * *

(2) The amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.

3. Section 6532(b) of the Internal Revenue Code of 1986, 26 U.S.C. § 6532(b), provides:

SUITS BY UNITED STATES FOR RECOVERY OF ERRONEOUS REFUND — Recovery of an erroneous refund by suit under section 7405 shall be allowed only if such suit is begun within 2 years after the making of such refund, except that such suit may be brought at any time within 5 years from the making of the refund if it appears that any part of the refund was induced by fraud or misrepresentation of a material fact.

4. Section 7405 of the Internal Revenue Code of 1986, 26 U.S.C. § 7405, provides in relevant part:

(a) REFUNDS AFTER LIMITATION PERIOD —Any portion of a tax imposed by this title, refund of which is erroneously made, within the meaning of section 6514, may be recovered by civil action brought in the name of the United States.

(b) REFUNDS OTHERWISE ERRONEOUS — Any portion of a tax imposed by this title which has been erroneously refunded (if such refund would not be considered as erroneous under section 6514) may be recovered by civil action brought in the name of the United States.

* * *

(d) PERIODS OF LIMITATION —

For periods of limitations on actions under this section, see section 6532(b).

STATEMENT OF THE CASE

A. Factual Background

The Petitioners in this case are Kevin M. O'Gilvie and Stephanie L. O'Gilvie (sometimes hereinafter referred to as "the O'Gilvie children"). The O'Gilvie children are the minor children of Betty O'Gilvie, who died April 2, 1983, of toxic shock syndrome (Pet. App. 3a, 28a). INTRUST Bank, NA is the conservator for each of the O'Gilvie children. Kelly M.

O'Gilvie, the husband of Betty O'Gilvie, acting as administrator of her estate and as guardian of the O'Gilvie children brought a successful product liability suit against International Playtex, Inc., the manufacturer of the tampons Betty O'Gilvie used (Pet. App. 3a). Following a trial, a jury awarded actual damages of $1,525,000 and punitive damages of $10,000,000. *See O'Gilvie v. International Playtex, Inc.*, 609 F. Supp. 817, 818 (D. Kan. 1985), *aff'd in part and rev'd in part,* 821 F.2d 1438 (10th Cir. 1987), *cert. denied,* 486 U.S. 1032 (1988). The district court ordered a remittitur of the punitive award to $1,350,000, 609 F. Supp. at 819-820, but the Tenth Circuit ordered reinstatement of the full punitive award, 821 F.2d at 1448-1449.

In 1988, the Estate of Betty O'Gilvie received the proceeds of the punitive damages award, totaling, net of attorney's fees and expenses, $4,967,292 (Pet. App. 3a). Kevin and Stephanie each received one-fourth (1/4) of the net proceeds, or $1,241,823 each. (Pet. App. 3a). The conservator, on behalf of the O'Gilvie children, reported and paid tax on their shares of the punitive damages on their individual federal income tax returns for 1988, the year the funds were distributed by the estate to the conservator.

In August 1989, Kelly O'Gilvie filed a claim for refund with respect to his 1988 income taxes, asserting that punitive damages were excluded from his gross income under § 104(a)(2) as damages received "on account of personal injury." When the Internal Revenue Service (hereinafter "IRS") took no action on his refund claim he filed suit against the United States to recover the refund plus interest (App. 22a). The parties filed cross-motions for summary judgment, each asserting there was no genuine issue of material fact and that the taxability of punitive damages could be decided as a matter of law (Pet. App. 4a).

In November 1989, the O'Gilvie children each filed a claim for refund on the ground that the punitive damages award was

excluded from gross income under § 104(a)(2) as damages received "on account of personal injury " (Pet. App. 4a). On April 13, 1990, the IRS, by letter to the Joint Committee on Taxation, requested that a refund be made to the O'Gilvie children (App. 74a). On May 3, 1990, the Joint Committee on Taxation approved the requested refunds to the O'Gilvie children (App. 76a). The IRS informed the children of the Joint Committee on Taxation's decision on June 6, 1990 (App. 78a). On July 9, 1990, the conservator received in the mail, from the United States Treasury, two checks, each in the amount of $392,160.37, representing the federal income tax refund claimed by each of the O'Gilvie children, plus interest (App. 79a). Each check bears an issue date of July 6, 1990 (App. 79a).

On July 9, 1992, the IRS filed its complaint herein against the O'Gilvie children, seeking under § 7405 to recover as erroneously made the refunds that had been paid to them, asserting that the punitive damages award was taxable (App. 60a). On August 20, 1993, in accordance with an agreement entered into by INTRUST Bank, NA, as conservator of the O'Gilvie children, and the United States, the district court entered a Stipulation and Order (Pet. App. 37a-40a), paragraphs 10 and 14 of which provide as follows:

> 10. The legal issues in this case are identical to the legal issues in the case of *Kelly O'Gilvie v. United States*, Civil No. 90-1075-B (D. Kan.), and the parties to this litigation therefore agree to be bound by the final judgment of the district court in *Kelly O'Gilvie v. United States*, Civil No. 90-1075-B (D. Kan.) (subject to the provisions contained in paragraphs 13 and 14 below).

* * *

14. Both parties reserve the right to appeal any adverse determination on the merits in this case.

(Pet. App. 39a).

B. Proceedings Below

On May 26, 1992, the district court ruled (Pet. App. 25a-27a), that the punitive damages Kelly O'Gilvie received were taxable. However, on that same day this Court issued its opinion in *United States v. Burke*, 504 U.S. 229 (1992). In view of the *Burke* decision, Kelly O'Gilvie moved for reconsideration of the decision against him (Pet. App. 25a). On August 26, 1992, the district court granted Kelly O'Gilvie's motion and reversed its May 26, 1992, decision, holding that punitive damages are excludable from gross income under § 104(a)(2) (Pet. App. 28a). The district court granted summary judgment for Kelly O'Gilvie, and, pursuant to the Stipulation and Order (Pet. App. 37a), also granted summary judgment to the O'Gilvie children on the punitive damages issue.

The United States appealed the district court decision (App. 68a), and the Court of Appeals for the Tenth Circuit reversed. The Tenth Circuit addressed the question whether § 104(a)(2) excludes a punitive damages award in a personal injury action. The court noted that four other circuits have determined that punitive damages in personal injury cases are not excludable under § 104(a)(2) (Pet. App. 13a, citing *Wesson v. United States*, 48 F.3d 894 (5th Cir. 1995); *Hawkins v. United States*, 30 F.3d 1077 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 2576 (1995); *Reese v. United States*, 24 F.3d 228 (Fed. Cir. 1994); *Commissioner v. Miller*, 914 F.2d 586 (4th Cir. 1990)). The court observed (Pet. App. 14a-16a) that one circuit had held to the contrary (*Horton v. Commissioner*, 33 F.3d 625, 630 (6th Cir. 1994)), basing its conclusion on this Court's decision in *United States v. Burke*, 504 U.S. 229 (1992).

The Tenth Circuit observed that the issue in *Burke* was whether a claim under Title VII of the Civil Rights Act of 1964 redressed "a personal injury" within the meaning of § 104(a)(2). This Court in *Burke* stated that as to what constitutes "a personal injury" the statute was ambiguous and the legislative history was not instructive. Therefore, this Court relied on the regulation relating to the statute, which defined "damages" as "an amount received . . . through prosecution of a legal suit or action based upon tort or tort type rights." Treas. Reg. § 1.104-1(c) (1958). This Court noted that under traditional tort law, a variety of remedies are available, including pain and suffering, emotional distress, harm to reputation, and punitive damages. Because Title VII does not provide these types of remedies, this Court concluded that a Title VII claim was not a tort type of personal injury claim (Pet. App. 14a-15a).

The Tenth Circuit then noted that this Court in *Commissioner v. Schleier*, 515 U.S. __, 115 S. Ct. 2159 (1995), addressed whether ADEA liquidated damages are excludable under § 104(a)(2) and held that they are not (Pet. App. 15a). This Court in *Schleier* stated that neither the recovery of back wages nor liquidated damages under ADEA are "on account of" personal injury. 515 U.S. at __, 115 S. Ct. at 2164-2165. This Court noted the requirement in Treas. Reg. § 1.104-1(c) that the recovery "be received in a tort type action is not a substitute for the statutory requirement that the amount be received 'on account of personal injuries or sickness'; it is an additional requirement." 515 U.S. at __, 115 S. Ct. at 2166. This Court then concluded that:

> the plain language of § 104(a)(2), the text of the applicable regulation, and our decision in *Burke* establish two independent

> requirements that a taxpayer must meet before a recovery may be excluded under § 104(a)(2). First, the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is "based upon tort or tort type rights" and second, the taxpayer must show that the damages were received "on account of personal injuries or sickness."

(Pet. App. 16a, quoting 515 U.S. at __, 115 S. Ct. at 2167).

In neither *Burke* nor *Schleier* did this Court have occasion to address whether the phrase "on account of" personal injuries in § 104(a)(2) is ambiguous (Pet. App. 16a). The Tenth Circuit, however, noted that the statutory requirement that damages be received "on account of" personal injuries is subject to more than one interpretation: It could be read to refer broadly to any award received in a personal injury suit; or it could be read more narrowly to refer only to damages awarded "on account of" the injury itself and not to damages awarded "on account of" the nature of the conduct of the defendant (Pet. App. 17a, quoting *Reese v. United States*, 24 F.3d at 230-231). Finding nothing in the history of the statute that made clear whether Congress intended to exclude punitive damages from income under § 104(a)(2), the Tenth Circuit applied what it characterized as the "default rule" that exclusions from income are to be narrowly construed. Thus, the Tenth Circuit held that punitive damages are not excludable from income under § 104(a)(2) (Pet. App. 22a, citing *United States v. Burke*, 504 U.S. at 248 (Souter, J. concurring)).

The Tenth Circuit also held that the government's suit for recovery of the children's refunds was timely, on the basis that the filing of the complaint on July 9, 1992, was within two years of the children's receipt of the refund checks in the mail on July

9, 1990 (Pet. App. 10a). To the children's argument that the date of mailing of the refund checks is the date which commences the running of the two year limitation period under § 6532(b), the court replied that a statute of limitation generally does not begin to run "until a suit could be brought" and assumed that an action does not lie at least until the taxpayer receives the refund check because until that point the government could still stop payment on the check (Pet. App. 9a-10a).

SUMMARY OF ARGUMENT

The language of § 104(a)(2) excludes "*any* damages received . . . on account of personal injuries or sickness" from taxable income (emphasis added). The statutory language draws no distinction between the taxability of compensatory and punitive damages. Indeed, a plain and common sense reading of the statute indicates that the damages the O'Gilvie children received in this case were "on account of personal injuries or sickness." But for the personal injuries the O'Gilvie children's mother sustained, neither compensatory nor punitive damages would have been awarded in this case. Thus, the punitive, as well as the compensatory, damages were received on account of personal injuries.

The language of § 104(a) is substantially unchanged from that originally enacted as § 213(b)(6) of the Revenue Act of 1918, Pub. L. No. 65-254, 40 Stat. 1057, 1066 (1919). The codifications of the Internal Revenue Code in 1939 and 1954 did not alter any of the substantive language from the original enactment. The codifications merely restructured the original language into separate clauses and added headings to the sections.

The plain language of the original provision demonstrates that Congress intended to exclude punitive damages from taxable income in the circumstances presented here. Congress

expressly distinguished between amounts received through accident or health insurance or workmen's compensation acts on the one hand and amounts received by suit or agreement on account of personal injuries on the other hand. As to the former, Congress excluded only amounts received "as compensation for personal injuries." But as to the latter, Congress excluded "any damages" so received. This significant distinction in the original statutory language demonstrates congressional intent that punitive, as well as compensatory, damages received by suit or agreement on account of personal injuries be excluded from taxable income. Although some courts considering the exclusion of punitive damages under § 104(a)(2) have found the section to be ambiguous, none of them, including the Tenth Circuit below, have addressed or analyzed Congress' intent evidenced in the original statutory language and the critical distinction made in that language. In violation of principles of sound statutory construction, these courts resort to less reliable aids of construction.

Further, the IRS in Rev. Rul. 75-45, 1975-1 C.B. 47, interpreted the language in § 104(a)(2) as providing that "any damages, whether compensatory or punitive, received on account of personal injuries or sickness are excludable from gross income." *Id.* However, in Rev. Rul. 84-108, 1984-2 C.B. 18, the IRS reversed its position, relying on *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), which did not address personal injuries as in the present case. Adherence to Rev. Rul. 84-108 will not create uniformity in taxation of damage awards, but rather result in an individual being subject to federal tax, or not, depending on how the laws of his state of residence characterize the award.

The 1989 amendment to § 104(a)(2) further evidences congressional intent that punitive damages be excluded from taxable gross income. The amendment provided that § 104(a)(2)

"shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness." Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641, 103 Stat. 2106, 2379 (1989).[3] The clear and *only* reasonable implication from the 1989 amendment is that, at least in cases involving physical injury, punitive damages received in lawsuits filed prior to its effective date of July 10, 1989, are not taxable. Any other interpretation renders the 1989 amendment meaningless.

The date of the "making" of a tax refund by check should be either the date the check is issued or mailed by the government. The plain implication of the words used in § 6532(b) is that the event which triggers the limitation period ("making" the refund) is an event which requires the participation of the government only, not the taxpayer. Thus, the occurrence of the taxpayer's receipt — which depends on many variables such as the speed of mail delivery, the distance between the taxpayer and the IRS, and whether delivery would ordinarily fall on a holiday or Sunday — is irrelevant under the statute. In *United States v. Wurts*, 303 U.S. 414 (1938), this Court held that "making," as used in the predecessor to § 6532(b), means "paying," but the Court did not decide whether "paying" means mailing or receiving. *Id.* at 418. For the sake of simplicity and certainty in the administration of tax law, the expiration of the statute of limitations should be determinable by reference to a date which is readily available to both the government and the taxpayer. That date is the date the government either issues or mails the refund check.

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3. The amended statute does not apply here since the underlying lawsuit was filed, and the damages were received, by the O'Gilvie children before the July 10, 1989, effective date of the amendment.

ARGUMENT

I.

SECTION 104(a)(2) EXCLUDES A PUNITIVE DAMAGES AWARD RECEIVED IN A PERSONAL INJURY LAWSUIT FROM TAXABLE INCOME

A. Introduction

The first step in calculating taxable income under the Internal Revenue Code is to determine the taxpayer's "gross income." "'Except as otherwise provided in this subtitle, gross income means all income from whatever source derived.' 26 U.S.C. § 61(a)." *Commissioner v. Schleier,* 515 U.S. __, 115 S. Ct. 2159, 2163 (1995).

Petitioners recognize that "Congress intended through § 61(a) and its statutory precursors to exert 'the full measure of its taxing power,' *Helvering v. Clifford,* 309 U.S. 331, 334, 60 S. Ct. 554, 556, 84 L. Ed. 788 (1940), and to bring within the definition of income any 'accessio[n] to wealth.' *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 431, 75 S. Ct. 473, 477, 99 L. Ed. 483 (1955)." *Burke,* 504 U.S. at 233.

This Court has also noted a "corollary to § 61(a)'s broad construction, namely the 'default rule of statutory interpretation that exclusions from income must be narrowly construed.' *United States v. Burke,* 504 U.S., at 248, 112 S. Ct., at 1878 (Souter, J., concurring in judgment); see *United States v. Centennial Savings Bank FSB,* 499 U.S. 573, 583, 111 S. Ct. 1512, 1519, 113 L. Ed.2d 608 (1991); *Commissioner v. Jacobson,* 336 U.S. 28, 49, 69 S. Ct. 358, 369, 93 L. Ed., 477 (1949); *United States v. Burke,* 504 U.S., at 244, 112 S. Ct., at 1875-1876 (Scalia, J., concurring in judgment)." *Schleier,* 515 U.S. at __, 115 S. Ct. at 2163.

Against this backdrop, however, § 104(a)(2) clearly and on its face excludes from taxable income the damages at issue in this case. Section 104(a)(2) provides that gross income does not include "the amount of *any damages* received . . . on account of personal injuries or sickness" (emphasis added). In an *en banc* decision, the Tax Court, in *Miller v. Commissioner,* 93 T.C. 330, 338 (1989) (15 to 2 decision), *rev'd,* 914 F.2d 586 (4th Cir. 1990), stated "we read 'any damages' to mean 'all' damages, including punitive damages." *Horton v. Commissioner,* 100 T.C. 93, 95 (1993) (16 to 3 decision expressly rejecting the reasoning and holding of the Fourth Circuit's reversal in *Miller*), *aff'd,* 33 F.3d 625 (6th Cir. 1994). Further, as set forth in this Brief, the plain language of the statute; the statute's history; the IRS' own revenue rulings, as well as Tax Court decisions; and Congress' 1989 amendment to § 104 to provide that the provision's exclusion "shall not apply to any punitive damages in connection with a case not involving physical injury or sickness," Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239 § 7641, 103 Stat. 2106, 2379 (1989), all lead to the inexorable conclusion that the punitive damages received in this case were received "on account of personal injuries" and, therefore, excluded under § 104(a)(2).

B. By Excluding "Any Damages Received . . . On Account Of Personal Injuries Or Sickness," § 104(a)(2) On Its Face Excludes Punitive Damages Received In A Personal Injury Action

Section 104 of the Internal Revenue Code provides certain specific exclusions from the definition of gross income provided by § 61(a). Section 104(a)(2) provides, in relevant part: "[G]ross income does not include — . . . (2) the amount of any damages received . . . on account of personal injuries or sickness." It is undeniable that the damages the O'Gilvie children received through the action against International

Playtex, Inc. are damages received "on account of personal injuries or sickness." The damages were awarded on account of the death of their mother Betty O'Gilvie by toxic shock syndrome caused by International Playtex's tampon product (Pet. App. 3a).

The language of § 104(a)(2) states that *any* damages received on account of personal injuries or sickness are excluded from gross income and, thus, taxation. The starting place in the construction of any statute is with the language of the statute itself. *See Ankenbrandt v. Richards*, 504 U.S. 689, 707 (1992); *Community v. Reid*, 490 U.S. 730, 739 (1989); *Mead Corp. v. Tilley*, 490 U.S. 714, 722 (1989); *Consumer Product Safety Comm. v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). It is a cardinal rule of statutory construction that "the words of statutes — including revenue acts — should be interpreted where possible in their ordinary, everyday senses." *Crane v. Commissioner*, 331 U.S. 1, 6 (1947).

An ordinary, everyday meaning of "any damages" would be "all damages." *See* Merriam Webster's Collegiate Dictionary 53 (10th ed. 1993) (providing a definition of the term "any" as including "every" or "all"); Black's Law Dictionary 86 (5th ed. 1979) ("The word any has a diversity of meaning and may be employed to indicate 'all' or 'every' as well as 'some' or 'one' and its meaning in a given statute depends upon the context and the subject matter of the statute.") Such a meaning encompasses punitive damages.

All the damages received by the O'Gilvie children, whether compensatory or punitive, were received "on account of" the personal injuries relating to the death of their mother. "On account of" is defined to mean "for the sake of," "by reason of," or "because of." Websters Third New International Dictionary (1981). The Tax Court in *Miller*, 93 T.C. at 339, noted "[t]hese

phrases suggest causation." But for the personal injuries sustained, the O'Gilvie children would not have recovered any damages, whether compensatory or punitive. Sustaining personal injuries is directly and causally connected to the recovery of any damages. A finding of actual compensatory damages is generally necessary to support an award of punitive damages.[4] The statutory language of § 104(a)(2) does not distinguish between compensatory and punitive damages regarding exclusion from taxation. *Any* damages received on account of personal injuries are excluded by § 104(a)(2).

The Sixth Circuit addressed the scope of § 104(a)(2) in *Horton v. Commissioner*, 33 F.3d 625 (6th Cir. 1994). Relying on this Court's opinion in *Burke*, the Sixth Circuit found the taxpayers' damages — both compensatory and punitive — were received "on account of" their personal injuries. Indeed, the court declared that the "plain meaning of the broad statutory language [of § 104(a)(2)] simply does not permit a distinction between punitive and compensatory damages." 33 F.3d at 631. The statutory language of § 104(a)(2), used in its ordinary, everyday sense, does not draw a distinction between punitive and compensatory damages.

C. The History Of § 104 Conclusively Demonstrates That The Punitive Damages Award In This Case Is Excludible From Gross Income

1. The language of § 104 is substantially unchanged from the language Congress originally enacted.

The relevant language of § 104(a)(2) is substantially unchanged from its original predecessor language enacted as

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4. *See* W. Keeton, D. Dobbs, R. Keeton & D. Owen, Prosser and Keeton on the Law of Torts 14 (5th ed. 1984).

part of the Revenue Act of 1918, Pub. L. No. 65-254, 40 Stat. 1057, 1066 (1919). In relevant part, Section 213(b)(6) of the Revenue Act of 1918 provided:

> Sec. 213. That for the purposes of this title . . . the term "gross income" . . . —
>
> (b) Does not include the following items, which shall be exempt from taxation under this title: . . .
>
> (6) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of *any* damages received whether by suit or agreement on account of such injuries or sickness.

40 Stat. at 1066 (emphasis added).

At the time of the Revenue Act of 1918, the definition of gross income was set forth in the preceding subsection, § 213(a). With the codification of the Internal Revenue Code in 1939 the definition of gross income became § 22(a) with the heading "General Definition." Section 22(b) of the 1939 Code enumerated the "Exclusions from Gross Income." Section 213(b)(6) then became, without change to the text, § 22(b)(5):

> Compensation for Injuries or Sickness. — Amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness.

26 U.S.C. § 22(b)(5) (1939). The 1939 Code only added a heading to subsection (b)(5).

The Internal Revenue Code was recodified in 1954. The 1954 Code restructured the sections pertaining to gross income and exclusions, but did not substantially alter any of the relevant language concerning "any damages received . . . on account of" personal injuries. Under the 1954 Code the definition of gross income became § 61. The various exclusions from gross income were grouped together as "Part III — Items Specifically Excluded from Gross Income." Section 22(b)(5) of the 1939 Code became § 104 under the 1954 Code and retained the same heading "Compensation for Injuries or Sickness" which the 1939 Code had added. While the 1939 Code had addressed amounts received through accident or health insurance, workmen's compensation acts and any damages received on account of personal injuries in a single sentence, the 1954 Code restructured this sentence into three separate, but substantively unrevised clauses. Section 104(a) of the 1954 Code, as originally enacted, provided in relevant part as follows:

> [G]ross income does not include —
>
> (1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;
>
> (2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;
>
> (3) amounts received through accident or health insurance for personal injuries or sickness . . . .

26 U.S.C. § 104(a) (1954). The critical language of § 104(a) remains unchanged to the present day.

2. The history of § 104(a)(2) demonstrates that Congress intended to exclude punitive damages received in personal injury suits from taxation.

The statutory language of the predecessor to § 104(a)(2), § 213 (b)(6) of the Revenue Act of 1918, demonstrates on its face that Congress intended to exclude punitive damages, as well as compensatory damages, received by suit or agreement on account of personal injuries. In the first clause for amounts received through accident or health insurance or under workmen's compensation acts, only amounts received "as compensation for personal injuries or sickness" were excluded. The second clause, for amounts received by suit or agreement, excluded "any" damages — not just compensatory damages — received on account of personal injuries or sickness.

At the time Congress enacted the Revenue Act of 1918, the availability of punitive damages had long been established.[5] Congress, aware of punitive damages,[6] could have in the second clause excluded only damages received "as compensation for"

5. *See Day v. Woodworth*, 54 U.S. 363, 371 (1851) ("It is a well established principle of the common law that, in actions of trespass and all actions on the case for torts, a jury may inflict what are called exemplary, punitive or vindictive damages upon a defendant. . . ."); Note, "Exemplary Damages in the Law of Torts", 70 Harv. L. Rev. 517, 518-520 (1957) (punitive damages have been a part of the English common law since the thirteenth century). *See also Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 274 n.19 (1989) (noting that punitive damages existed when the Bill of Rights was drafted).

6. *See Thompson v. Thompson*, 218 U.S. 611 (1910) (wherein this Court presumed the legislature to know the state of the common law).

personal injuries as it did in the first clause, or it could have excluded only "compensatory damages" in the second clause. It did neither. *See Miller v. Commissioner*, 93 T.C. at 338. Having restricted excludable damages to those received as compensation for personal injuries from accident or health insurance or under workmen's compensation acts, Congress did not place the same restriction on damages received by suit or agreement for personal injuries. Instead, Congress expressly excluded *any* damages received on account of personal injuries.

This distinction in the original statutory language cannot be assumed to be irrelevant or inadvertent. By focusing on compensatory amounts in the first clause, but not in the second clause, the original statutory language signified that any damages received by suit or agreement on account of personal injuries, whether compensatory or punitive, share a common basis for exclusion from taxation. Such a common basis supports a "but-for" definition of the "on account of" requirement. Thus, personal injuries are the essential prerequisite to excluding damages, whether compensatory or punitive, from taxable income. But for the personal injuries their mother sustained, the O'Gilvie children would not have received compensatory or punitive damages. Section 104(a)(2), both in its current form and as originally enacted in 1918, does not support a distinction between the taxation of compensatory damages and punitive damages received in personal injury suits.

3. The lower courts largely have ignored the history of § 104(a)(2).

The primary duty of courts in construing statutory language is to discern congressional intent as to the meaning of the language. *See, e.g., United States v. N.E. Rosenblum Truck Lines, Inc.*, 315 U.S. 50, 53 (1942). Where ambiguous, the meaning of the statutory language must be derived from a considered weighing of relevant aids to construction. *See, e.g.*,

United States v. Dickerson, 310 U.S. 554, 562 (1940). But the starting point for construing a statute is the language of the statute itself and absent expressed congressional intent to the contrary, that language ordinarily must be regarded as conclusive. *See, e.g., Ankenbrandt v. Richards*, 504 U.S. 689, 707 (1992); *Community v. Reid*, 490 U.S. 730, 739 (1989); *Mead Corp. v. Tilley*, 490 U.S. 714, 722 (1989); *Consumer Product Safety Comm. v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

None of the courts which have addressed the exclusion of punitive damages under § 104(a)(2) have addressed the critical distinction between the first and second clauses of the original statutory language. The lower courts, including the Tenth Circuit in the present case, have addressed only the question whether "the amount of any damages . . . on account of personal injuries or sickness" language in § 104(a)(2) is ambiguous.[7] The ambiguity these courts found has been summarized as follows: "Section 104(a)(2) could mean that all damages recovered in a personal injury suit are excluded, or it could mean that only those damages that purport to compensate the plaintiff for the personal injury suffered are received on account of personal injury." *Wesson*, 48 F.3d at 897. The Fourth Circuit in *Miller* defined the ambiguity it found in terms of "but-for" or "sufficient" causation.

7. *See Robinson v. Commissioner*, 70 F.3d 34 (5th Cir. 1995); *O'Gilvie v. United States*, 66 F.3d 1550 (10th Cir. 1995) (Pet. App. 1a); *Wesson v. United States*, 48 F.3d 894 (5th Cir. 1995); *Hawkins v. United States*, 30 F.3d 1077 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 2576 (1995); *Reese v. United States*, 24 F.3d 228 (Fed. Cir. 1994); *Commissioner v. Miller*, 914 F.2d 586 (4th Cir. 1990); *see also Bagley v. Commissioner*, 105 T.C. ___, No. 27 (Dec. 11, 1995) (Tax Court no longer will follow its opinion in *Horton v. Commissioner*, 100 T.C. 93 (1993) after *Commissioner v. Schleier*, 515 U.S. ___, 115 S. Ct. 2159 (1995)); *but cf. Horton v. Commissioner*, 33 F.3d 625, 631 (6th Cir. 1994) (plain meaning of § 104(a)(2) language does not permit a distinction between punitive and compensatory damages).

> Under a but-for causation approach, the fact that a plaintiff has to sustain a personal injury as a prerequisite to an award of punitive damages leads to the conclusion that the punitive damages were "on account of" the plaintiff's injury . . . . under a sufficient causation approach, the fact that personal injury is a prerequisite to punitive damages does *not* lead to the conclusion that the punitive damages were "on account of" the plaintiff's injuries because, even if the other elements of the tort are present, personal injury alone does not sustain a punitive damages award.

Miller, 914 F.2d at 590-591 (emphasis in original).

When they find § 104(a)(2) ambiguous, lower courts have resorted to a variety of extrinsic aids to interpret the statute. *See O'Gilvie* (Pet. App. 13a-14a). None of these courts, however, have analyzed the original statutory language as evidence of congressional intent. Neither have these courts analyzed the direct history behind the statute. Instead, they have resorted to more remote, less reliable aids for interpreting the language of § 104(a)(2).

The Fourth Circuit, for example, in *Miller v. Commissioner*, 914 F.2d 586 (4th Cir. 1990), chose to resolve the ambiguity it found in the language of § 104(a)(2) by relying on what it viewed as the statute's underlying purpose. *Id.* at 590. The Fourth Circuit ascertained that underlying purpose not by examining the original statutory language or Congress' intent in enacting that language, but by relying on *Starrels v. Commissioner*, 304 F.2d 574 (9th Cir. 1962), a case decided some forty-four years after the original enactment. "Damages paid for personal injuries are excluded from gross income because they make the taxpayer

whole from a previous loss of personal rights — because, in effect, they restore a loss to capital." *Starrels*, 304 F.2d at 576.

Unfortunately, at least two other courts of appeals also have relied on *Starrels* without considering the original statutory language. *See Wesson*, 48 F.3d at 899; *Hawkins*, 30 F.3d at 1083. Not only is *Starrels* an inappropriate source for ascertaining the statute's purpose, but the Ninth Circuit's discussion of purpose was dicta because the court found that no personal injury had occurred. *Starrels*, 304 F.2d at 575.

Starrels, in turn, relied on *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). While *Glenshaw Glass Co.* addressed the taxation of punitive damages, it did so in the context of § 22(a) of the 1939 Code, the definition of gross income. The Court concluded that exemplary damages for fraud and the punitive portion of a treble-damage antitrust recovery were "undeniable accessions to wealth, clearly realized" which fit within the encompassing definition of gross income provided by § 22(a). *Id.* at 428-429. What *Glenshaw Glass Co.* did not address was the exclusion of punitive damages received on account of personal injuries under § 22(b)(5) of the 1939 Code, the immediate predecessor to the present § 104(a)(2). No personal injuries were at issue in *Glenshaw Glass Co.* Thus, the Court had no need to, and did not, set forth a "restoration of capital" rationale under then § 22(b)(5).[8] While *Glenshaw Glass Co.* may properly be recognized as an important opinion defining

8. In reaching its decision in *Glenshaw Glass Co.*, the Court noted that the actual damages received in the case were taxable, which caused the Court to state "it would be an anomaly that could not be justified in the absence of clear congressional intent to say that a recovery for actual damages is taxable but not the additional amount extracted as punishment for the same conduct which caused the injury." *Id.* at 431. This same anomaly occurs when punitive damages are taxed but compensatory damages are excluded when both result from the conduct which caused the injury.

gross income, it simply is not relevant to the interpretation of § 104(a)(2).

Other courts have adopted a "return of capital" theory that only compensatory recoveries are excludable under § 104(a)(2) because they merely make the plaintiff whole from injuries suffered and do not represent an accession to wealth. *See, e.g., Reese v. United States*, 24 F.3d 228, 223 (Fed. Cir. 1994); *Commissioner v. Miller*, 914 F.2d 586, 590 (1990). The return of capital theory is objectionable on more than just statutory construction grounds.[9] When examined, a return of capital rationale does not satisfactorily explain why certain compensatory damages are excludable under § 104(a)(2). *Hawkins*, 30 F.3d at 1087 (Trott, J., dissenting) (example given of automobile accident causing personal injuries which results in recovery of compensatory damages for lost earnings). The recovery of lost earnings on account of personal injuries is clearly excludable under § 104(a)(2). But the plaintiff has been made more than whole. If the plaintiff had worked for those earnings, the plaintiff would have been required to pay taxes on the earnings. But because of the injuries, the plaintiff received more money than if the plaintiff had worked. The same can be argued for the recovery of damages for pain, suffering and emotional distress that can not be measured with precision as in an automobile accident. *See Schleier*, 515 U.S. at __, 115 S. Ct. 2163-2164. Again, the plaintiff is made more than whole. Thus,

9. The return of capital theory has been widely criticized as a means of explaining the § 104(a)(2) exclusion. *See, e.g., Downey v. Commissioner*, 97 T.C. 150, 159 (1991), *supplemental opinion*, 100 T.C. 634 (1993), *rev'd on other grounds*, 33 F.3d 836 (7th Cir. 1994), *cert. denied*, 115 S. Ct. 719 (1995); Cochran, *1989 Tax Act Compounds Confusion over Tax Status of Personal Injury Damages*, 49 Tax Notes 1565, 1573 (1990); Henning, *Recent Developments in the Tax Treatment of Personal Injury and Punitive Damage Recoveries*, 45 Tax Law. 783, 796 (1992); Henry, *Torts and Taxes, Taxes and Torts: The Taxation of Personal Injury Recoveries*, 23 Hous. L. Rev. 701, 725 (1986).

compensatory damages, like punitive damages, can represent more than a return of capital. *Hawkins*, 30 F.3d at 1087. Even the Tenth Circuit in this case found the return of capital theory "problematic." *O'Gilvie* (Pet. App. 19a).

Further, adoption of the return of capital theory does not foster judicial economy. Making punitive damages received on account of personal injuries taxable would result in litigation over the proper characterization of damages resulting from the settlement of personal injury actions. The vast majority of such actions are settled prior to trial. Under a return of capital theory, parties would have an incentive to avoid characterizing any part of the settlement as punitive damages in order to permit the plaintiff to take advantage of the § 104(a)(2) exclusion.[10] If, however, the parties failed to distinguish between the compensatory and punitive portion of a settlement, or the IRS challenged the parties' characterization, the return of capital theory would require a factual determination of not only whether the suit involved "personal injury or sickness," but also the measure of damages necessary to "compensate" the plaintiff. Such a factual determination approximates the very type of litigation the parties intended to avoid by the settlement. *Miller*, 93 T.C. at 343-344 (1989) (Ruwe, J., concurring).

Some courts have relied on the fact that § 104 is entitled "Compensation for Injuries or Sickness" as evidence of how Congress had only compensatory damages in mind when it enacted § 104(a)(2). *O'Gilvie* (Pet. App. 18a); *Wesson*, 48 F.3d at 898; *Hawkins*, 30 F.3d at 1083; *Reese*, 24 F.3d at 231, citing *Immigration and Naturalization Serv. v. National Ctr. for Immigrants*, 502 U.S. 183, 189-90 (1992) ("the title of a statute

10. The IRS has ruled that punitive damages incurred by a taxpayer in the ordinary conduct of business operations are deductible as an ordinary and necessary business expense. Rev. Rul. 80-211, 1980-2 C.B. 57, 58. Thus, the defendant's tax consequences are the same regardless of how the damage award is titled.

or section can aid in resolving an ambiguity in the legislation's text"); *Miller*, 914 F.2d at 590. This reliance overlooks the fact that, as discussed above,[11] the title was not added to the provision until the 1939 codification of the Internal Revenue Code, some twenty-one years after the original enactment. This addition of titles, as part of a codification process at a remote point in time and when no reconsideration or revision of the substantive language took place, surely is not reliable evidence of Congress' intent in 1918, the time of the original enactment. Indeed, such reliance contradicts the clear admonition of § 7806(b) of the Internal Revenue Code to disregard such material as a tool for interpreting the Code:

> No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, *nor shall any table of contents . . . or similar outline, analysis, or descriptive matter* relating to the contents of this title *be given any legal effect.*

26 U.S.C. § 7806(b) (emphasis added).

Several lower courts also have relied upon the placement of paragraph (2) in § 104(a) among the other paragraphs to which compensatory purposes are attributed, as evidence of the compensatory purpose of paragraph (2). *O'Gilvie* (Pet. App. 18a); *Wesson*, 48 F.3d at 899; *Reese*, 24 F.3d at 231. Again, this reliance fails to recognize that paragraphs (1), (2) and (3) were originally all part of *the same sentence* in the Revenue Act of 1918. As discussed above,[12] in that sentence Congress drew a

11. *See* page 16, *supra*.

12. *See* page 18, *supra*.

distinction between accident or health insurance or workmen's compensation, in one instance, and personal injury suits in the other. That sentence remained unchanged until the 1954 codification of the Internal Revenue Code restructured it into three separate, but unrevised clauses. To give weight to the "statutory context" of § 104(a)(2) without examining the history behind that structure ignores congressional intent.

Finally, some courts which have held that the language of § 104(a)(2) does not encompass punitive damages rely on the principle, *see, e.g., Commissioner v. Schleier*, 515 U.S. __, __, 115 S. Ct. 2159, 2163 (1995); *United States v. Burke*, 504 U.S. 229, 248 (1992) (Souter, J., concurring); *Commissioner v. Jacobson*, 336 U.S. 28, 49 (1949), that exclusions to taxable income are to be narrowly construed. *O'Gilvie* (Pet. App. 18a); *Wesson*, 48 F.3d at 898; *Hawkins*, 30 F.3d at 1030; *Reese*, 24 F.3d at 231; *Miller*, 914 F.2d at 590. The petitioners do not dispute this principle, but they do object to premature resort to its use by the courts as a "default rule." Courts viewing the principle of narrow construction as a "default rule" may forego thorough, critical consideration of the language and history of the statute in question.

Indeed, that is precisely what the Tenth Circuit did in this case. Despite opining that the return of capital theory is "somewhat problematic," *O'Gilvie* (Pet. App. 19a), and being "further troubled" by the language of the 1989 amendment to § 104(a)(2), *Id.* (Pet. App. 19a), the Tenth Circuit concluded:

> In sum, it is not clear whether Congress intended to exclude punitive damages from income under §104(a)(2). Although "good reasons tug each way" in this case, we need not decide "which tug harder," because we must follow the default rule that exclusions from income are narrowly construed.

Id. (Pet. App. 22a), quoting *United States v. Burke*, 504 U.S. 229, 248 (Souter, J. concurring). *See also Brabson v. United States*, 73 F.3d 1040, 1047 (10th Cir. 1996) (addressing whether statutorily mandated prejudgment interest awarded in a personal injury suit is excluded by §104(a)(2), "[l]astly, though perhaps most importantly, we are guided by the default rule. . . .").

The principle of narrow construction of exclusions to income must, however, fit within the basic framework for statutory interpretation. The "default rule" does not relieve a court from the duty to evaluate all traditional and relevant aids to construction. Rather, application of the default rule should arise, if, and only if, after carefully scrutinizing a statute's language and history, its meaning remains indecipherable. In other words, courts should not quickly conclude that any uncertainty as to the meaning of a statute triggers the "default rule," as the Tenth Circuit did in this case.

In sum, the Tenth Circuit and other courts holding that § 104(a)(2) does not encompass the exclusion of punitive damages received in personal injury cases have failed to consider the history of § 104(a)(2), including importantly the original statutory language of § 213(b)(6) of the Revenue Act of 1918. As a result, these courts improperly have concluded that § 104(a)(2) is ambiguous and does not exclude punitive damages from gross income.

D. The IRS Itself Has At Times Interpreted § 104(a)(2) To Exclude From Income Punitive Damages Received In Personal Injury Cases

In 1975, the IRS held in Rev. Rul. 75-45, 1975-1 C.B. 47, that "any damages, whether compensatory or punitive, received on account of personal injury or sickness are excludable from gross income." This revenue ruling addressed the issue of

whether the estate of an employee, killed while a passenger in his employer's airplane, had to include as income a sum received under the terms of the employer's aircraft liability insurance policy, or whether such amount was excludable from gross income under § 104(a)(2). The revenue ruling noted that the payments were in exchange for a release of any claims brought under the wrongful death act of the decedent's state of residence. A series of court decisions had established that the payments made under such act were considered punitive in nature. *Id.* The revenue ruling phrased the question as "whether the amount received . . . is excludable from gross income as 'damages received * * * on account of personal injuries or sickness' under the provisions of section 104(a)(2) of the Code, or whether it is includible in gross income as 'punitive damages' under the provisions of section 1.61-14(a) of the Income Tax Regulations." *Id.* In finding that the entire payment the estate received was excludable under § 104(a)(2), the revenue ruling stated:

> Section 104(a)(2) excludes from gross income 'the amount of *any* damages received (whether by suit or agreement) *on account of* personal injuries or sickness' (emphasis added). Therefore, under section 104(a)(2) any damages, whether compensatory or punitive, received on account of personal injures or sickness are excludable from gross income. (emphasis in original)

Id.

Revenue Ruling 75-45 deals with a situation very similar to this case. The injury suffered in both instances is a personal injury, death, and in both instances damages were received. The IRS, in this revenue ruling, correctly observes that *any* damages

received *on account of* personal injuries, whether compensatory or punitive, are excludable from gross income under the plain language of the statute.

Approximately nine years later, however, the IRS issued a contrary ruling with Rev. Rul. 84-108, 1984-2 C.B. 32.[13] This revenue ruling held that § 104(a)(2) does not exclude a punitive damages award from gross income.

The facts in Rev. Rul. 84-108 are essentially the same as those set forth in Rev. Rul. 75-45, with the exception that the wrongful death claim at issue in situation one of Rev. Rul. 84-108 was brought under the laws of Virginia, a state that does not permit the recovery of punitive damages awards in wrongful death cases, while the claim at issue in situation two of Rev. Rul. 84-108 was brought under the laws of Alabama, a state that provides exclusively for punitive damages awards in wrongful death cases. Revenue Ruling 84-108 concludes that a payment made under the Virginia wrongful death statute is excluded from gross income, since the payment is for compensatory damages. However, the IRS concluded that a payment made under the Alabama wrongful death statute is not excluded from gross income, because such damages are deemed to be exclusively punitive damages. Therefore, according to this revenue ruling, a taxpayer, or his estate, will be subject to federal taxation, or not, depending on how their state of residence characterizes the damages at issue.

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13. In Rev. Rul. 58-418, 1958-2 C.B. 18, the taxpayer received an amount in settlement of a libel suit in which the taxpayer had sought compensatory and punitive damages for the publication of false and defamatory matter tending to injure his personal reputation. Relying on *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), this revenue ruling held that the punitive damages received were not excludable from income. 1958-2 C.B. at 19.

Of the two approaches, the one adopted in Rev. Rul. 75-45 not only creates uniformity in the treatment of damages received, but also gives effect to the plain language of § 104(a)(2), namely that gross income does not include any damages received . . . on account of personal injuries or sickness.[14] *See Miller*, 93 T.C. at 342 (Ruwe, J., concurring). Moreover, the interpretation of Rev. Rul. 84-108 is inconsistent with the "generally accepted principle that Congress normally intends that its laws shall operate uniformly throughout the nation." *Reconstruction Finance Corporation v. Beaver County*, 328 U.S. 204, 209 (1946).

The Tax Court in *Miller v. Commissioner*, 93 T.C. 330, 338-340 (1989) noted how at one time the IRS, in Rev. Rul. 75-45, was of the opinion that compensatory and punitive damages received on account of personal injuries were excludable from gross income, but that the IRS had reversed its position in Rev. Rul. 84-108. *Id.* at 339. The Tax Court found Rev. Rul. 84-108 unpersuasive as it relied on *Glenshaw Glass Co.*, which did not involve taxpayers who received any recoveries on account of personal injuries. *Id.* The Tax Court found the plain meaning of the statutory language of § 104(a)(2) did not permit a distinction between punitive and compensatory damages. *Id.* at 338. The court went on to state that the plain meaning of a statute should not be disregarded except to prevent an absurd result or one contrary to legislative intent. *Id.* at 340-341 (citing *United States v. American Trucking Assns., Inc.*, 310 U.S. 534, 543 (1940)). Finding no such exceptions, the Tax Court held that punitive damages were excluded from gross income by § 104(a)(2). *Id.* at 341.

14. Although General Counsel Memoranda have no precedential value it is interesting to note that in G.C.M. 37398 (Jan. 31, 1978) the Internal Revenue Service acknowledged that the conclusion reached in Rev. Rul. 75-45 is based on a plausible interpretation of the statutory language and that the word "any" is broad enough to cover punitive as well as compensatory damages. The Internal Revenue Service further acknowledged that the conclusion reached in Rev. Rul. 75-45 has the "desirable effect of creating uniformity in the treatment of damages received under the wrongful death statutes of the various states." *Id.* at n.2.

The Tax Court addressed the issue again in *Horton v. Commissioner*, 100 T.C. 93 (1993). Rejecting the return of capital theory used by the Fourth Circuit to reverse *Miller*, the Tax Court reaffirmed its decision in *Miller*. *Id.* at 96. The court found that whether damages are paid on account of personal injuries is determined by the nature of the underlying claim. *Id.* "Once the nature of the underlying claim is established as one for personal injury, any damages received on account of that claim, including punitive damages, are excludable." *Id.*

E. The 1989 Amendment To § 104(a)(2) Further Confirms That The Courts Should Interpret The Pre-1989 Version Of The Statute To Exclude Punitive Damages

In 1989, Congress amended § 104(a)(2) to provide that the provision's exclusion "shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness." Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, Section 7641, 103 Stat. 2106, 2379 (1989). This amendment does not apply to this case because by its terms, it is not applicable to any recovery of punitive damages under an agreement made, or pursuant to a lawsuit filed, on or before July 10, 1989. *Id.* Nonetheless, one reasonable implication arising from the 1989 amendment is that, as to recoveries on lawsuits filed or agreements made prior to July 10, 1989, all punitive damages on account of personal injury were not taxable; as to recoveries on lawsuits filed or agreements made after July 10, 1989, only punitive damages received in cases involving physical injury or sickness are excludable. *See also Burke*, 504 U.S. at 235 n.6 ("Congress amended § 104(a) to

allow the exclusion of *punitive* damages only in cases involving 'physical injury or physical sickness' ") (emphasis in original).

The genesis of the 1989 amendment appears to be in a reaction to court decisions in which § 104(a)(2) was applied to exclude punitive damages awarded in cases where the individual sustained no physical injury.[15] In explaining the reason for the amendment the House Ways and Means Committee stated that damages for personal injuries should only be excluded when physical personal injuries were involved. *See Revenue Reconciliation Bill of 1989, Explanation of revenue provisions as approved by the House Ways and Means Committee on September 14, 1989*, p. 238. At the Conference Committee it was agreed that "the exclusion for damages received for personal injury does not apply to punitive damages in cases not involving physical injury or sickness." Revenue Provisions of Conference Agreement on H.R. 3299, Omnibus Budget Reconciliation Act of 1989, released by Senate Finance Committee on November 21, 1989, p. 147. This amendment to § 104(a)(2) obviously does not illuminate the intent of Congress in 1918 when it passed the original statute. It does, however, create a situation in which the IRS will receive a windfall at the O'Gilvie children's expense if the plain language of the pre-1989 version of § 104(a)(2) is not given its ordinary and logical meaning.[16]

15. *See, e.g., Miller v. Commissioner*, 93 T.C. 330 (1989), *rev'd*, 914 F.2d 586 (4th Cir. 1990) (defamation and emotional distress, a nonphysical injury).

16. In holding punitive damages taxable, at least one court has characterized receipt of such damages as a windfall and likened it to the plaintiff winning the lottery. *Hawkins v. United States*, 30 F.3d 1077, 1083-1084 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 2576 (1995). Such a glib characterization is perhaps understandable in a case such as *Hawkins* where the plaintiff's injury was receipt of an inferior car without certain options as a replacement for a car totaled in an accident. However, the O'Gilvie children (Cont'd)

It offends common sense to construe the 1989 amendment to § 104(a)(2) in any other fashion, for "if Congress wanted to clarify that all punitive damages were taxable, why did the amendment create a distinction between physical and nonphysical injury?" *Hawkins*, 30 F.3d at 1086-1087 (Trott, J., dissenting).[17] The IRS must also have been of the understanding that the punitive damages award received by the O'Gilvie children was not subject to taxation as the IRS not only authorized the refunds, but requested, in accordance with § 6405(a), that the Joint Committee on Taxation approve the refunds (App. 74a). The Joint Committee, after examining the basis on which the O'Gilvie children sought the refunds, agreed that the refunds should be allowed (App. 76a). Not until two years after the refunds were received did the IRS have a change of heart and file a lawsuit seeking recovery of the refunded amounts (App. 60a). The O'Gilvie children find this somewhat confusing in light of the fact that it is the Commissioner who

(Cont'd)
have clearly not received a windfall as a result of the punitive damages award received in this matter. They lost their mother and unlike the car in *Hawkins* she cannot be replaced nor can their loss be precisely measured. The only windfall in this case will be to the government as a result of timing should this Court determine the punitive damages received by the O'Gilvie children are taxable. Had the O'Gilvie children filed suit and received the punitive damages award after the 1989 amendment to § 104(a)(2), the proceeds would clearly be excluded from income. *United States v. Burke*, 504 U.S. at 235, n.6.

17. Most commentators agree with this interpretation of the 1989 amendment. *See* Andrews, *The Taxation of Title VII Victims After the Civil Rights Act of 1991*, 46 Tax Law. 755, 766 (1993); Cochran, *1989 Tax Act Compounds Confusion over Tax Status of Personal Injury Damages*, 49 Tax Notes 1565, 1567 (1990); Henning, *Recent Developments in the Tax Treatment of Personal Injury and Punitive Damage Recoveries*, 45 Tax Law. 783, 801 (1992); Jaeger, *Taxation of Punitive Damage Awards: The Continuing Controversy*, 57 Tax Notes 109, 114 (1992). *Compare* Kahn, *Taxation of Punitive Damages Obtained in a Personal Injury Claim*, 65 Tax Notes 487 (1994).

issued Rev. Rul. 84-108, and it is presumed that the Commissioner is aware of her own rulings. In short, the 1989 amendment further confirms that punitive damages obtained in all personal injury suits should be excludable from gross income prior to 1989.

II.

THE GOVERNMENT'S SUIT TO RECOVER THE REFUNDS MADE TO THE O'GILVIE CHILDREN WAS UNTIMELY

A. Introduction

When the United States believes that it has made an erroneous refund to a taxpayer, it may bring suit to recover the refund, but "only if such suit is begun within two years after the making of such refund. . ." 26 U.S.C. § 6532(b). The question presented in this case is when the *making* of a refund occurs in the context of a refund check mailed to the taxpayer — the date the check is issued, the date it is mailed or the date the taxpayer receives it.

The United States brought this suit against the O'Gilvie children by filing a complaint in the United States District Court for the District of Kansas on July 9, 1992, seeking to recover the income tax refunds which it had paid to them (App. 60a). The refunds had been paid in the form of United States Treasury checks dated July 6, 1990 (App. 79a), which were received by the children's conservator, by United States mail, on July 9, 1990. *O'Gilvie* (Pet. App. 10a). Thus, the suit was brought more than two years after the issuance and/or mailing of the checks, but exactly two years after the children's conservator received the checks in the mail.

If this Court holds that the *making* of a refund, within the

meaning of § 6532(b), occurs on or after the date upon which a refund check is delivered to a taxpayer, then the suit brought by the United States in this case was timely. If, however, this Court holds that the *making* of a refund occurs either on the date the refund check is issued or is placed in the mail by the government, the government's suit is untimely.

B. The Tenth Circuit Adopted An Erroneous Interpretation Of § 6532(b) In Holding That The Statute Does Not Commence Running Until The Taxpayer *Receives* The Refund

The Tenth Circuit held in this case that the delivery to or receipt by the taxpayer of the refund check is the event which commences the statutory limitations period, in large part on the basis that "a statute of limitation does not begin to run until a suit could be brought." *O'Gilvie* (Pet. App. 10a), quoting *Paulson v. United States*, 78 F.2d 97, 99 (10th Cir. 1935). The Tenth Circuit opined:

> Here, the government could not have brought suit to recover the refund until the taxpayers had received the refund checks on July 9, 1990. Thus, the statute of limitations began to run on July 9, 1990, when taxpayers received their refund checks.

O'Gilvie (Pet. App. 10a).

The interpretation of a statute should be grounded on the words used and their ordinary meaning as enacted. *See Consumer Product Safety Comm.*, 447 U.S. at 108; *Crane*, 331 U.S. at 6. With respect to § 6532(b), the statute declares that the two year limit for filing suit is measured from the *making* of the refund. The statute does not mention the date that the government could first have brought suit. Indeed, if Congress

had meant for the two year period to begin running on the first day a suit could be brought to recover the refund, Congress could have so provided.

Under the statutory language, the start of the two year limitations period is not triggered by an event involving the taxpayer. Instead, § 6532(b) establishes a period which commences upon an act which is solely within the control of the IRS (the *making* of the refund). In common sense terms, the IRS *makes* a refund when a check is signed and deposited with the postal authorities for delivery to the taxpayer. At that point there is nothing further for the IRS to do in order to *make* the refund.

Congress' choice of words in § 6532(b) is crucial. Congress did not provide that the statutory trigger is the *payment* of a refund. Such language would arguably have been more consistent with the Tenth Circuit's holding in this case. The term *payment* logically may be construed to imply that the payee has received satisfaction of the presumed obligation. But Congress chose the term *making*, which suggests a different conclusion; that is, that the payee is not involved in the act which triggers the two year period. The concept of *payment* of a refund logically is susceptible to the construction that it involves not only the *making* of the refund but also its receipt by the taxpayer while only the IRS' conduct is necessary to the *making* of a refund. Because § 6532(b) uses the narrower term *making* rather than the broader term *payment*, the two year limitations period under § 6532(b) should begin, at the latest, when the IRS completes the last act required of it in order for the refund to be *made*— the placing of the check in the mail.

The Tenth Circuit in the present case found that the term *made* must mean *received* by the taxpayer because until receipt by the taxpayer, payment on the check could be canceled or stopped, so the refund is not *made* until that opportunity has

passed. A similar argument was rejected in *United States v. Woodmansee*, 388 F. Supp. 36 (N.D. Cal. 1975), *rev'd on other grounds*, 578 F.2d 1302 (9th Cir. 1978), and *United States v. Bruce*, 642 F. Supp. 120 (S.D. Tex. 1986). These cases held that the limitation period commences prior to the time that the taxpayer cashes the check. They so held even though the government could, theoretically, stop payment on the check *after* the taxpayer receives it. 31 U.S.C. § 3328(a)(1).[18]

C. This Court's Decision In *United States v. Wurts*, 303 U.S. 414 (1938), Does Not Support The Tenth Circuit's Interpretation of § 6532(b)

This Court has addressed § 6532(b) only once, in the form of its predecessor, § 610 of the Revenue Act of 1928, in *United States v. Wurts*, 303 U.S. 414 (1938). In *Wurts*, the government's complaint was filed more than two years after the IRS approved a refund, but less than two years after the refund check was mailed to the taxpayer. The taxpayer contended that Congress intended for the two year limit to be measured from the date the Commissioner approved or allowed the refund (the date the Commissioner signed a schedule of overassessments). This Court disagreed, finding that "[o]nly by ignoring the common understanding of words could 'making . . . [a] refund' be considered synonymous with 'allowing a refund.' " *Id.* at 417.

In *Wurts*, this Court speculated that Congress did not intend that a statute of limitations should begin to run "before the right barred by it has accrued." *Wurts*, 303 U.S. at 418. The Court did not speculate when such right might have accrued, but held only

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18. 31 U.S.C. § 3328(a)(1) provides "[e]xcept as provided in sections 3329 and 3330 of this title, a check drawn on the Treasury may be paid at any time. However, if the Secretary of the Treasury is on notice of a question of law or fact about the check when the check is presented, the Secretary shall defer payment until the Comptroller settles the questions."

that the statutory period "begins to run from the date of payment." *Id.* at 418. Although *Wurts* used the term "payment," there was no mention of a date of delivery, receipt by the taxpayer, presentment or any other such date, other than the date the refund check was mailed. In fact, in its statement of the facts of the case, this Court referred to the mailing as "actual payment." *Id.* at 415. Therefore, this Court could only have meant in *Wurts* that the two year period commences on the date that the IRS places the refund check in the mail for delivery to the taxpayer.

In the present case, the refund checks had to have been mailed no later than Sunday, July 8, 1990, in order for the conservator to have received them in the mail on Monday, July 9, 1990. Since the government's complaint in this case was not filed until July 9, 1992, this suit was begun more than two years after the *making* (mailing) of the refund, and recovery is therefore barred under § 6532(b) and *Wurts*, contrary to the Tenth Circuit's decision.

D. Policy and Practical Considerations Do Not Support The Tenth Circuit's Interpretation Of § 6532(b)

Reference to the dates of receipt by taxpayers of checks delivered by mail would not result in uniform payment dates, and it would be difficult, if not impossible, for the IRS to determine the dates of receipt and thus the dates by which the government must file suits for recovery of erroneous refunds.

"High public interests make it necessary that there be stability and certainty in the revenues of government. These ends are not susceptible of attainment if periods of limitation may be disregarded or extended." *Daube v. United* States, 289 U.S. 367, 372 (1932). Indeed, modern society evinces even greater demand for simplicity, closure and certainty in tax administration. Requiring that the government's suits be filed by

deadlines which must be determined by reference to dates which are known only to taxpayers (if at all) would not provide such simplicity or certainty. In the words of the court in *Bruce*, such a rule would "allow an extension of the limitations statute based on the unpredicted conduct of the taxpayer. . . ." *Bruce*, 642 F. Supp. at 122 n.1. For example, actual receipt by the taxpayer might occur only after (1) the refund check has been delivered to a previous address and forwarded to the taxpayer at his current address; (2) when the taxpayer returns from vacation and picks it up at his post office box or at the general delivery window of the post office; or (3) after the local post office reopens following a Sunday, a holiday or even a natural disaster.

Moreover, a rule that the "making" of a refund occurs when the taxpayer receives it would create additional problems for the government. As just one example, under the Revenue Adjustment Act of 1975, P.L. No. 94-164, § 2(d) (1975), as amended by the Revenue Act of 1978, P.L. No. 95-600, § 105(f) (1978),[19] it is necessary for the government to know the month in

19. The Revenue Adjustment Act of 1975, Pub. L. No. 94-164, § 2(d) (1975), as amended by Revenue Act of 1978, Pub. L. No. 95-600, § 105(f) (1978), provides:

> (d) Disregard of Refund. — Any refund of Federal income taxes made to any individual by reason of section 43 of the Internal Revenue Code of 1954 (relating to earned income credit), and any payment made by an employer under section 3507 of such Code (relating to advance payment of earned income credit) shall not be taken into account in any year ending before 1980 as income or receipts for purposes of determining the eligibility, for the month in which such refund is made or any month thereafter which begins prior to July 1, 1976, of such individual or any other individual for benefits or assistance, or the

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which a refund is *made* for purposes of determining eligibility of the taxpayer or his family for benefits or assistance under federally financed programs. As another, under § 6514(a)(2)[20] it is necessary for the IRS to know whether a refund was *made* before or after the expiration of the period of limitation for filing

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> amount or extent of benefits or assistance, under any Federal program or under any State of local program financed in whole or in part with Federal funds, but only if such individual (or the family unit of which he is a member) is a recipient of benefits or assistance under such a program for the month before the month in which such refund is made.

20. Section 6514(a) of the Internal Revenue Code of 1986, 26 U.S.C. § 6514(a), provides:

> (a) CREDITS OR REFUNDS AFTER PERIOD OF LIMITATION. — A refund of any portion of an internal revenue tax shall be considered erroneous and a credit of any such portion shall be considered void —
>
> (1) EXPIRATION OF PERIOD FOR FILING CLAIM. — If made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; or
>
> (2) DISALLOWANCE OF CLAIM AND EXPIRATION OF PERIOD FOR FILING SUIT. — In the case of a claim filed within the proper time and disallowed by the Secretary, if the credit or refund was made after the expiration of the period of limitation for filing suit, unless within such period suit was begun by the taxpayer.
>
> (3) RECOVERY OF ERRONEOUS REFUNDS. — For procedure by the United States to recover erroneous refunds, see sections 6532(b) and 7405.

suit, for purposes of determining whether the refund was erroneous. And yet another example, under § 9503(c)(3),[21] the Secretary of the Treasury must be able to determine whether a refund is *made* before or after July 1, 2000, for purposes of determining the amount of his required payment from the Highway Trust Fund into the general fund of the Treasury under § 6412(a). In each of these situations Congress surely did not mean that a refund is *made* only when the taxpayer receives the refund check. Such a rule would result in considerable uncertainty and would be unworkable as a practical matter.

Finally, a rule that the *making* of a refund occurs when the taxpayer receives it may encourage the government to allege that a refund was received by the taxpayer at a late date, in hopes that the taxpayer will be unable to prove to the contrary. This Court should not countenance a rule that creates such incentives. At the least, such disputes would ordinarily have to be resolved by fact-finders.

On the other hand, the date of issuance of a refund check or the date of mailing are dates which are always available to the government and generally to the taxpayer, thereby providing simplicity, closure and certainty in tax administration, and minimizing instances of controversy such as in this case.

21. Section 9503(c)(3) of the Internal Revenue Code of 1986, 26 U.S.C. § 9503(c)(3) provides:

> (3) 1988 FLOOR STOCKS REFUNDS. — The Secretary shall pay from time to time from the Highway Trust Fund into the general fund of the Treasury amounts equivalent to the floor stocks refunds made before July 1, 2000, under section 6412(a).

CONCLUSION

For the foregoing reasons, petitioners respectfully request that the Court reverse and hold that the government's refund suit was untimely or, in the alternative, that the punitive damages award in this case was not taxable.

Respectfully submitted,

ROBERT M. HUGHES
Counsel of Record
JACK D. FLESHER
GREGORY L. FRANKEN
DAVID B. SUTTON
BEVER, DYE, MUSTARD & BELIN, L.C.
Attorneys for Petitioners
Kevin M. O'Gilvie and
Stephanie L. O'Gilvie
106 West Douglas, Suite 700
Wichita, Kansas 67202
(316) 263-8294

STEPHEN R. McALLISTER
Of Counsel
University of Kansas School of Law
Green Hall
Lawrence, Kansas 66045
(913) 864-4550